

Service Date: May 19, 1982

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * *

IN THE MATTER Of The Application)	
Of The CITY OF GREAT FALLS To)	UTILITY DIVISION
Increase Water Rates and Modify Rules)	DOCKET NO. 81.8.71
and Regulations.)	ORDER NO. 4902
_____)	

APPEARANCES

FOR THE APPLICANT:

John C. Doubek, Attorney at Law, 314 Fuller Avenue, Helena, Montana 59601.

FOR THE INTERVENORS:

John C. Allen, Staff Attorney, Montana Consumer Counsel, 34 West Sixth Avenue,
Helena, Montana 59620

James A. Robischon, Attorney at Law, Suite E, 1941 Harrison Avenue, Butte, Montana
59702, appearing on behalf of the Little Chicago Water Company, Black Eagle, Montana.

FOR THE COMMISSION:

Robert Nelson, Staff Attorney, Public Service Commission, 1227 - Eleventh Avenue,
Helena, Montana 59620.

BEFORE:

Gordon E. Bollinger, Chairman
John B. Driscoll, Commissioner
Howard L. Ellis, Commissioner
Clyde Jarvis, Commissioner and Presiding Officer
Thomas J. Schneider, Commissioner

FINDINGS OF FACT

1. On August 20, 1981, the City of Great Falls, Montana (Applicant or City) filed an application with this Commission for authority to increase rates and charges for water service to customers in its Great Falls, Montana service area. The Applicant requested an average increase of approximately 47%, constituting an annual revenue increase of approximately \$1,121,711.

2. On January 26, 1982, pursuant to Notice of Public Hearing, a hearing was held in the City Council Chambers, Civic Center, Great Falls, Montana. For the convenience of the consuming public a night (7:00 P.M.) session was held that date, at the same location. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustment and rule modifications.

3. At the public hearing, the City presented the following four witnesses:

Al Johnson, City Manager
Jan Dolan, Director of Administrative Services
Robert Duty, Public Works Director
Tom Thomas, Consulting Engineer

These witnesses testified relative to: the need for the proposed capital improvements, the estimated cost of the proposed capital improvements, the financing of the proposed capital improvements, the financial condition of the water utility, the allocation of indirect expenses, the current condition of plant in service and rate structure.

4. The Montana Consumer Counsel presented the testimony of numerous public witnesses. The major concerns expressed by the public witnesses were: the magnitude of the proposed capital improvements program, the magnitude of the revenue increase necessary to fund the capital improvement program, past expenditures of capital improvement funds and the improper transfer or loaning of water utility funds to other City departments.

5. J. R. Davis, Manager, Little Chicago Water Company (LCWC) gave testimony relative to the present financial condition of LCWC and the need for an increase in water rates to its consumers in an amount equal to the increase granted the City, since LCWC purchases 100% of its water from the City. The witness further testified that LCWC should not be required to

assume any amount of the increase allowed that is assignable to the proposed capital improvement program, because the proposed improvements are not caused by LCWC receiving water from the City and such improvements will not benefit LCWC.

6. State Representative, Paul Pistoria, questioned the City's spending of funds granted by this Commission in Docket No. 6373, Order No. 4250 (City of Great Falls' last general rate increase application), for proposed capital improvements. Mr. Pistoria noted that in Docket No. 6373 the City had outlined a proposed capital improvement program, that certain of these improvements had not been completed, and that the City had included the uncompleted improvements in this application. It was Mr. Pistoria's position that the City had been granted funding to make these capital improvements and that it is improper for the City to again ask for funding of the same improvements without explaining where the original funds have been spent.

7. The City's witnesses, testifying in response to Mr. Pistoria's questions, stated that, subsequent to the issuance of this Commission's Order No. 4250, the priorities on completion of capital improvements had been modified. The allowed funds had been diverted to make improvements to the water treatment plant, which had cost approximately \$1,000,000. The City has also accumulated \$1,842,593, at fiscal year end 1981, in unencumbered funds which are available for capital improvements.

8. The Commission finds that the City has not utilized the funds granted in Order No. 4250 for the capital improvements originally outlined, but also finds that the City has made a reasonable management decision and elected to utilize the funds for improvements that it determined had a higher priority, and to accumulate remaining funds in water utility accounts. The Commission further finds, given the City's explanation of capital improvement fund utilization, that no impropriety exists in the City's request for funding of uncompleted capital improvements from the prior docket. The Commission does caution the City that it should attempt to comply with the capital improvement programs outlined in its filings to simplify management accountability.

9. Mr. Pistoria also raised a question relative to the possibility of the City improperly transferring or loaning water utility funds to other City departments. Cross-examination of City witnesses does not indicate that they have any knowledge of improper transfer of water utility funds or that water utility funds have been loaned to other City departments. The Commission's examination of the City of Great Falls' audit reports for the years 1979 through 1981 did not reveal any improper transfers or loans to other City departments. The Commission finds, based upon the record developed in this docket, that the City has not improperly transferred or loaned water utility funds to other departments.

10. Representative Pistoria also questioned the City relative to funds being provided from the Water Department to fund a portion of the cost of an industrial park development in 1976. Commission investigation has shown that the City provided funds from the water utility to pay for the difference in cost between an 8 inch main, which was the size necessary to provide water to the industrial park, and the 12 inch main that was installed. The City installed a 12 inch main at an additional cost of approximately \$25,000, to insure that growth in the area would not obsolete the new main. The Commission finds this to be a legitimate expense that should be borne by the utility.

11. The City in its application has set forth a proposed capital improvement program for the water utility. The City proposes a 2 to 3 year construction program to be funded from the current revenues of the water utility and a revenue bond issue with a term of 20 years. The City has also described additional improvements, for Commission information, that are not included in the 2 to 3 year construction program and are not under consideration in this docket (See Exhibit #1, Pages II-12 through II-16 for capital improvement program.)

12. The City has identified \$9,977,700 in capital improvements that require immediate action. The improvements requiring immediate action include: the water transmission system, the water distribution system, the water treatment plant and the installation of approximately 8,000 water meters as a conservation measure.

13. The capital improvements outlined by the City as requiring immediate action are intended to insure that the City has an adequate supply of water to meet future demands and to promote water conservation.

14. The Commission finds that the improvements requiring immediate action, as outlined in the capital improvement program, are reasonably prudent, and therefore accepts them. The Commission also accepts the City's estimated cost of \$9,977,700 as being a reasonable estimate of the construction costs.

15. The City proposes to finance the majority of the capital improvements requiring immediate action through the issuance of revenue bonds. The total funding for capital improvements needed in the future is not under consideration in this case. The City does state that the increase under consideration in this docket will not be sufficient to fund all of the identified needed improvements (Exhibit #1, p. III-11).

16. The City proposes to issue \$6,900,000 in revenue bonds to be repaid over a period of 20 years with the requirement that the City establish a reserve fund in an amount equal to the average principal and interest payment on the bond, and also provide a debt service coverage of 125%.

17. The City has elected to issue bonds in an amount less than the total required to finance the entire capital improvement program under consideration. The City proposes to finance the capital improvement program from bond proceeds, as well as unencumbered reserve funds and the current net operating revenues of the utility.

18. The Commission finds the proposed financing mechanism for the proposed capital improvements to be reasonably prudent and therefore accepts the City's proposal.

OPERATION AND MAINTENANCE EXPENSE AND REVENUES

19. The Applicant presented the following expenses and revenues, for fiscal years 1930 through 1983:

PROJECTED EXPENSES AND REVENUES

OPERATING EXPENSES

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>
Administration	\$ 303,464	\$ 340,000	\$ 395,000	\$ 434,000
Distribution	281,687	330,000	385,000	424,000
Pump & Filtration	<u>629,029</u>	<u>665,600</u>	<u>689,000</u>	<u>758,000</u>
Total Operating Expenses:	\$1,214,180	\$1,335,600	\$1,469,000	\$1,616,000

NON-OPERATING EXPENSES

Annual Capital Expenses for Equipment & Other Items not in Capital Improvements Program	\$ 857,215	\$ 100,000	\$ 100,000	\$ 100,000
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Allocations to:

Revenue Bond Payment	\$ 446,600	\$ 447,000	\$ 447,000	\$ 447,000
Additional Revenue Bond Payment			410,000	820,000
25% Debt Service Coverage	<u>111,650</u>	<u>112,000</u>	<u>215,000</u>	<u>317,000</u>
Total Allocation for Revenue Bonds:	\$ 557,250	\$ 559,000	\$1,072,000	\$1,584,000

Depreciation	<u>302,086</u>	<u>200,000</u>	<u>200,000</u>	<u>200,000</u>
Total Expenses:	\$2,931,731	\$2,194,600	\$2,841,000	\$3,500,000

OPERATING REVENUE

Sales and Service Charges	\$2,212,208	\$2,014,000	\$2,702,000	\$3,258,000
Hydrant Rentals & Other Income	117,575	118,000	118,000	192,000
Charges for Services - Other Funds	<u>48,506</u>	<u>48,000</u>	<u>50,000</u>	<u>50,000</u>
Total Operating Revenue:	\$2,378,289	\$2,180,000	\$2,870,000	\$3,500,000

NON-OPERATING REVENUE

Interest Income	\$ 251,857	\$ 290,000	\$ 240,000	\$ 190,000
Available for Capital Improvements	\$ 112,151	\$ 587,400	\$ 684,000	\$ 707,000

20. The test year in this case is the fiscal year ending June 30, 1980, adjusted for an annual inflation rate of 10%. The Applicant used 1980 as its test year because it was the latest complete year of operation at the time of filing. Prior to the hearing in this docket, the financial information for fiscal year 1981 became available. Examination of the 1981 audit report indicates that the Applicant's projected operating revenue and expense closely paralleled the actual experience of the utility. Because the actual revenue and expense of the utility closely parallel the projected revenue and expense for fiscal year 1981, and the year 1981 being the latest historical year, the Commission finds it appropriate to utilize fiscal year 1981 as the test year.

21. The 1981 audit report reflects operating revenues of \$2,169,231, operating expenses of \$1,299,646 and interest income of \$308,745.

22. Financial note 2B of the 1981 audit report and response #4 from Applicant in the February 10, 1982 Memo from Jan Dolan to Al Johnson indicate water operating revenues for fiscal year 1981 should be increased by \$45,319. With this adjustment the actual 1981 operating revenues are \$2,214,550.

23. There was discussion on the record relative to the appropriate inflation factor to be utilized to determine projected operating expenses for the utility. The Consumer Counsel questioned the Applicant concerning the inflation rate as measured by the Consumer Price Index (CPI). The response indicated that CPI had an inflation rate at the time of between 8.5% and 8.9%. The Applicant has applied an inflation factor of 10% to determine projected operating expenses. The Commission recognizes that the correct inflation rate used to calculate projected operating expenses is highly subjective. However, given the fact that the inflation rate has slowed, and that the increase in operation and maintenance expense between the fiscal years 1980 and 1981 was approximately 7% ($\$1,299,646 \div \$1,214,180 = 7.03\%$), the Commission finds it appropriate to apply the CPI rate of 8.9% to determine projected expenses.

24. Utilizing fiscal year 1981 as a starting point and an inflation rate of 8.9%, the Commission finds the following operation and maintenance expense appropriate:

<u>1981</u>	<u>1982</u>	<u>1983</u>
\$1,299,646	\$1,415,314	\$1,541,277

25. The Applicant has requested \$100,000 annually for the purchase of capital items such as backhoes, trucks, and office equipment, and to provide general funding for items not included in the capital improvement program. The Commission finds the request for \$100,000 annual funding for capital items not included in the improvement program and for maintaining the rolling stock of the utility to be reasonable and can be funded from the debt service coverage.

26. The Applicant has also requested that the Commission allow \$200,000 annually for "depreciation", an amount which the applicant contends is less than the actual depreciation rate attributable to the system. The Applicant states that the "depreciation" allowance would be used to make part of the capital improvements outlined in its program and that this is a minimum amount necessary for funding the improvements requiring immediate action. It is not the Commission's general policy to allow municipal utilities to fund a "depreciation" account because it is the usual and recommended practice of municipal utilities to fund capital improvements through revenue bonds which are repaid over the useful life of the improvement. If the Commission were to allow municipal utilities to fund a "depreciation" account, given the wide spread use of revenue bonds, the Commission would be allowing the utility to charge the current rate payer twice for the same asset or capital improvement. Even though the City intends to utilize the \$200,000 for funding a portion of the capital improvement program, the Commission rejects the City's request for funding of a "depreciation" account.

DEBT SERVICE

27. The Applicant has a current outstanding revenue bond with an annual principal and interest payment of \$447,000 and a coverage ratio of 125%. The City does not anticipate retiring this bond issue with the issuance of the proposed \$6,900,000 bond issue. Therefore, the City will be incurring bond payments that are additional to those just described.

28. The testimony in this docket indicates that the \$6,900,000 bond issue will have an annual principal and interest payment of \$820,000 and coverage ratio of 125%. This testimony was not contested by any party in this proceeding, and it is therefore accepted by the Commission.

29. Under the present bond ordinance, the City is required to have Net Operating Income of at least \$111,750 to meet the 125% coverage ratio. To determine Net Operating Income, operation and maintenance expense as well as debt service are subtracted from the total revenues of the utility. With the issuance of the proposed bond issue, the Net Operating Income of the utility will have to be at least \$316,750 ($\$820,000 \times .25 = \$205,000 + \$111,750 = \$316,750$).

30. With the maintenance of bond reserve and construction accounts, there will be interest income accruing to the utility. The Applicant testified that construction of the proposed capital improvements would begin approximately six weeks after rates were approved and that the proposed revenue bonds would not be sold until approximately three months after receiving the order.

31. Absent the ability to determine the precise interest income that will accrue to the utility on its construction funds and reserve accounts, the Commission accepts the City's interest income calculations.

REVENUE NEED

32. The Commission finds the following to be the reasonable operating expenses and debt service for the utility for fiscal years 1982 and 1983:

	<u>1982</u>	<u>1983</u>
Operating Expense	\$1,415,314	\$1,541,277
Debt Service	<u>447,000</u>	<u>1,267,000</u>
TOTAL EXPENSE	\$1,862,314	\$2,808,277

The 1983 total expense assumes that the bonds will be sold prior to July 1, 1982. This may not in fact occur, but the Commission chooses to calculate expenses in this manner as the most reasonable way of accounting for the effect of the proposed bond issue on the operating statement of the utility.

33. Utilizing the test year revenues of \$2,214,550 and deducting allowed total expenses for projected year 1983, from Finding of Fact # 32, the utility would sustain an operating loss of \$593,727. If the Commission were to allow the Applicant to increase revenues by \$820,000 which is the principal and interest payment on the proposed bond issue, the Applicant's projected year 1983 revenues would increase to \$3,034,550 and result in the utility having an operating income of \$226,273.

34. In determining the appropriate revenue level for the utility the Commission must recognize that under the present bond indenture and the proposed bond indenture the utility is required to achieve a net operating income at the levels and in the manner described in Finding of Fact #29. Consistent with that requirement the utility would have net operating income for projected year 1982 of \$352,236 ($\$2,214,550 - \$1,862,314 = \$352,236$) which is above the necessary level outlined in Finding of Fact #29. For projected year 1983 the utility would have net operating come of \$226,273 ($\$3,034,550 - \$2,808,277 = \$226,273$) which is below the level outlined in Finding of Fact #29.

35. It must be pointed out that the calculations in Finding of Fact #34 omit one revenue component of the utility which is used in determining net operating income for the bond indenture. Neither calculation considers the interest income that will accrue to the water utility on the reserve accounts or the construction fund. As stated in Finding of Fact #31 the Commission cannot determine precisely the interest income that will accrue to the water utility but has accepted the Applicant's calculation. With the inclusion of interest income the 1982 net operating income would increase to \$592,236 ($\$352,236 + \$240,000 = \$592,236$) and the 1983 net operating income would increase to \$416,273 ($\$226,273 + \$190,000 = \$416,273$) which results in both net operating incomes being above the level required in Finding of Fact #29.

36. The Commission, based upon the Findings of Fact in this order, finds that the Applicant should be allowed to increase revenues by \$720,477 annually after the completion of the proposed revenue bond sale. This requirement is calculated as follows:

Operating Revenue	\$2,214,550
Interest Income	<u>190,000</u>
TOTAL REVENUE	\$2,404,550
Operating Expense	\$1,541,277
Debt Service	\$1,267,000
Debt Service Coverage	<u>\$ 316,750</u>
TOTAL REVENUE REQUIREMENT	\$3,125,027
Revenue Deficiency	\$ 720,477

RATE STRUCTURE

37. The City presented a traditional cost-of-service study utilizing the base-extra capacity method. In the base-extra capacity method all costs are separated into components of base cost, extra capacity cost and customer cost.

38. In the base-extra capacity cost allocation, each component of the water system's capital cost and operating cost relating to demand is assigned to a demand criteria (average annual consumption, maximum day demand or maximum hour demand) through the utilization of a linear equation. Customer costs are assigned directly since they are incurred irrespective of the amount of water used.

39. The Applicant's proposed rate structure includes a minimum charge and two declining rate blocks for all metered customers. The City also finds it necessary to perpetuate an unmetered rate structure because all services in the City of Great Falls are not metered.

40. Mr. J. R. Davis, Manager of the Little Chicago Water Company, Black Eagle, took exception to the costing methodology (employed by the Applicant. Mr. Davis objected to the extent that capital costs were allocated to his company from the proposed bond issue that did not benefit the Company. The Commission, without having a complete history of the capital

improvements made to the Applicant's system, cannot determine if capital improvements that did benefit LCWC were paid for exclusively by LCWC or whether rate payers on the Great Falls system contributed to payment of those improvements. Equity certainly requires that the direct cost assignment approach, suggested by LCWC, be consistently applied from the beginning. No such showing was made on this record, and the Commission is not aware of such an approach being followed by any Montana utility. Rather, the Commission finds that the City's water utility constitutes an integrated system. The fully allocated cost-of-service study recognizes the integrated system and provides the best evidence of record on customer class cost responsibility.

41. The Commission finds the Applicant's costing formula acceptable and the rate structure acceptable for both metered and unmetered service.

RULES AND REGULATIONS

42. The City in its application requested authorization to amend certain rules and regulations under which the utility operates. The Commission makes no finding regarding these changes in view of the fact that the 1981 legislature passed legislation allowing municipal utilities to adopt service rules and regulations without this Commission's approval (Title 69, Chapter 7, MCA).

MISCELLANEOUS

43. The Applicant in this docket has requested funding of a very extensive capital improvement program and the past history of the utility indicates that it is prone to modification of its capital improvement programs after receiving funding for the programs. Therefore, the Commission finds that the Applicant should file a quarterly account of all activity regarding the expenditure of capital improvement funds.

44. The Commission is aware that the Applicant is pursuing a cooperative meter reading program with other utilities operating in Great Falls. The Commission would urge the

Applicant to continue to pursue this program in an effort to reduce operating expense and provide more timely reading of the meters.

45. The Applicant proposes to read the meters in the community on a bi-monthly basis and render an actual bill every two months with an estimated billing sent during the interim month. After considering testimony concerning the City's billing practices, the Commission is of the opinion that the utility should bill every two months after the meter has actually been read. This will prevent the problems the City has experienced in the past relative to estimated billings.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the subject matter and parties in this proceeding.
2. The Commission afforded all interested persons notice and an opportunity to participate in these proceedings.
3. The rates approved herein are reasonable and just.

ORDER

NOW THEREFORE, at a session of the Public Service Commission, Department of Public Service Regulation of the State of Montana, held in its offices, 1227 - 11th Avenue, Helena, Montana, on the 17th day of May, 1982, there being present a quorum of Commissioners, there came regularly before the Commission for final action the matters and things in Docket No. 81.8.71, and the Commission being fully advised in the premises;

IT IS ORDERED by the Commission that the City of Great Falls shall file tariffs, consistent with the Finding of Facts herein, generating an annual revenue increase of \$720,477.

IT IS FURTHER ORDERED that the rates approved herein shall not become effective until the first day of the first month following the sale of the revenue bonds.

IT IS FURTHER ORDERED that the City shall submit a quarterly account of all activity regarding the expenditure of capital improvement funds.

DOCKET NO. 81.8.71; ORDER NO. 4902

IT IS FURTHER ORDERED that the City shall bill all consumers on a bi-monthly basis utilizing actual meter readings.

IT IS FURTHER ORDERED that a full, true and correct copy of this order be sent forthwith by first class United States mail to the Applicant and all other appearances herein.

THE FOREGOING was adopted by the Department of Public Service Regulation of the State of Montana, Public Service Commission IN OPEN SESSION at Helena, Montana on this 17th day of May, 1982, by a 5-0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

GORDON E. BOLLINGER, Chairman

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

CLYDE JARVIS, Commissioner

THOMAS J. SCHNEIDER, Commissioner

ATTEST:

Madeline L. Cottrill
Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review of the final decision in this matter. If no Motion for Reconsideration is filed, judicial review may be obtained by filing a petition for review within thirty (30) days from the service of this order. If a Motion for Reconsideration is filed, a Commission order is final for purpose of appeal upon the entry of a ruling on that motion, or upon the passage of ten (10) days following the filing of that motion. cf. the Montana Administrative Procedure Act, esp. Sec. 2-4-702, MCA; and Commission Rules of Practice and Procedure, esp. 38.2.4806 ARM.